

April 9, 1998

OPINION OF THE OFFICE OF GENERAL COUNSEL

ISSUE: Whether the Federal Home Loan Bank of \_\_\_\_\_ may permit a member to incorporate the Affordable Housing Program (AHP) recapture provisions of 12 C.F.R. § 960.13(d)(1), relative to owner-occupied units financed by a direct subsidy, into retention/recapture agreements that apply to the resale of owner-occupied units where the member will use a subsidized advance to finance only the construction costs of the units?

CONCLUSION:

The FHLBank of \_\_\_\_\_ may permit a member to incorporate the recapture provisions of 12 C.F.R. § 960.13(d)(1) into the retention/recapture agreements that apply to such owner-occupied units.

I. Introduction

This memorandum responds to a request from the Office of Policy to analyze an issue raised by the Federal Home Loan Bank of \_\_\_\_\_ (Bank). See Memorandum from Janet Fronckowiak, Program Analyst, through Richard Tucker, Deputy Director, to Deborah Silberman, General Counsel (March 18, 1998). In a fax transmittal dated March 11, 1998, the Bank references a request from \_\_\_\_\_, Counsel to \_\_\_\_\_ Bank, for the Bank's approval of the retention/recapture mechanism for the \_\_\_\_\_ at the \_\_\_\_\_ project (Project). See Fax Transmittal from \_\_\_\_\_, Federal Home Loan Bank of-to Richard Tucker, Finance Board (March 11, 1998); see also Letter from \_\_\_\_\_ to \_\_\_\_\_, Vice President and Director, Community Investment Services, Federal Home Loan Bank of \_\_\_\_\_ (March 9, 1998). Specifically, Counsel notes that § 960.13(c)(4) of the AHP regulation does not extend the AHP recapture requirements to the resale of owner-occupied units where the member will use a subsidized advance to finance the construction of the units. Therefore, Counsel asks whether the recapture provisions of § 960.13(d)(1), relative to direct subsidies, can be applied to the resale of the owner-occupied units within the Project.

II. Analysis

Section 960.13(c)(4) of the AHP regulation sets forth the required elements for retention/recapture agreements for AHP-assisted owner-occupied units financed by a loan from the proceeds of a subsidized advance. See 12 C.F.R. § 960.13(c)(4). Specifically, it requires such units to be subject to a deed restriction or other legally enforceable retention agreement or mechanism requiring that: 1) the Bank or its designee is to be

given notice of any sale or refinancing of the unit occurring prior to the end of the retention period; and 2) in the case of a refinancing prior to the end of the retention period, the full amount of the interest rate subsidy received by the owner, based on the pro rata portion of the interest rate subsidy imputed to the subsidized advance during the period the owner occupied the unit prior to refinancing, shall be repaid to the Bank from any net gain realized upon the refinancing, unless the unit continues to be subject to a deed restriction or other legally enforceable retention agreement or mechanism for the remainder of the 5-year retention period. See id.

In the instant matter, the Bank member, \_\_\_\_\_ Bank, will use an approved AHP subsidized advance to make a revolving construction loan to the developer to fund a portion of construction costs of the Project's 100 unit owner-occupied townhouses. As units are completed and conveyed to qualified purchasers, the developer will use the proceeds of the sales to repay the member, which in turn will make the repaid sums available for subsequent loan for the construction of additional units. When the last unit is conveyed, the remaining full, outstanding amount of the loan proceeds from a subsidized advance will be repaid by the member to the Bank.

Section 960.13(c)(4) does not address the situation where a member uses a subsidized advance to finance the construction of owner-occupied units and not to provide permanent financing for the purchase of the units. Where AHP funds are used to provide permanent financing, each is funded by a subsidized advance and incorporates some level of interest rate subsidy that benefits the household purchasing the unit during the term of the loan. Thus, there is a direct link between the subsidized advance and the permanent financing for the unit. For purposes of recapture, we can calculate clearly the pro rata portion of the interest rate subsidy imputed to each unit.

However, where a member uses a subsidized advance to finance only the construction costs of the units, the link between the advance and the permanent financing for each unit is less direct. Nonetheless, we believe that there is a reduced cost of building a unit, due to the subsidized financing of the construction loan, and this reduced cost is passed on to the purchaser in a reduction in the purchase price. We view this as being similar to a situation in which a purchaser receives a direct subsidy in the form of down-payment assistance, Section 960.13(d)(1) of the AHP regulation sets forth the required elements for retention/recapture agreements for AHP-assisted owner-occupied units financed by the proceeds of a direct subsidy. See id. § 960.13(d)(1). Specifically, § 960.13(d)(1)(ii) provides that, in the case of a sale prior to the end of the retention period, an amount equal to a pro rata share of the direct subsidy, reduced for every year the seller owned the unit, shall be repaid to the Bank from any net gain realized upon the sale of the unit after deduction for sales expenses, unless the purchaser is a low- or moderate-income household. See id. § 960.13(d)(1)(ii). Section 960.13(d)(1)(iii) provides that in the case of a refinancing prior to the end of the retention period, an amount equal to a pro rata share of the direct subsidy, reduced for every year the occupying household has owned the unit, shall be repaid to the Bank from any net gain realized upon the refinancing, unless the unit continues to be subject to a deed restriction

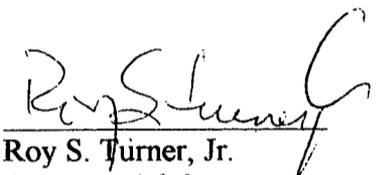
or other legally enforceable retention agreement or mechanism for the remainder of the retention period. See id. § 960.13(d)(1)(iii).

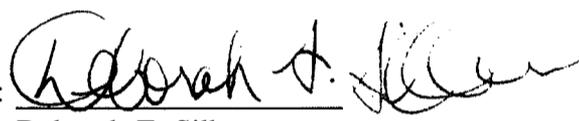
Based upon the foregoing, it is our view that where units are constructed with the proceeds of a subsidized advance, the amount of subsidy received by each purchaser is equal to a pro rata portion of the interest rate subsidy incorporated in the construction loan, based upon the price of the unit. Thus, in the event of a resale of a unit during the 5-year retention period to a purchaser that is not a low- or moderate-income household or in the event the owner refinanced the unit and did not maintain the AHP retention mechanism in place, the owner would be required to repay from any net gain realized upon the sale or refinancing, respectively, an amount equal to a pro rata share of such interest rate subsidy, based upon the price of the unit.

### III. Conclusion

Based upon the foregoing, we believe that Counsel's proposal to put in place retention/recapture agreements similar to those described in § 960.13(d)(1) of the AHP regulation for owner-occupied units financed by direct subsidies is appropriate. You may wish to work with the Bank to determine how much AHP subsidy should be imputed to each unit and, thus, reflected in each retention agreement. As you know, this issue also is expected to be addressed to provide for this result in proposed amendments to the AHP regulation.

  
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